1. **The time of receiving the benefit of a service is not the time of when expenditure is made**.

At its most fundamental level, the Republican Party complaint argues that the Napolitano campaign made an expenditure when it put up its initial web site on the afternoon of March 1, 2006. From this premise, the Republican Party complaint argues that the Napolitano campaign did not have funds to pay for that site and it therefore constituted a violation of R2-20-104(D)(6) (not making expenditures in excess of cash on hand). This argument, however, confuses the time of receiving the benefit of services and the time of making expenditures. Those are two distinct and different times and to try and conflate them to one point of time simply ignores the statutory definition of "expenditure" found in ARS 16-901(8).

ARS 16-901 defines expenditure as follows:

"8. 'Expenditures' includes any purchase, payment, distribution, loan, advance, deposit or gift of money or anything of value made by a person for the purpose of influencing an election in this state including supporting or opposing the recall of a public officer or supporting or opposing the circulation of a petition for a ballot measure, question or proposition or the recall of a public officer and a contract, promise or agreement to make an expenditure resulting in an extension of credit and the value of any in-kind contribution received."

For purposes of this complaint, the important language is the final phrase, "a contract, promise or agreement to make an expenditure resulting in an extension of credit. For purposes of this complaint, I will acknowledge that once the Napolitano campaign used the internet consultant's services by putting up the web site and sending out the emails, there was a contract with that consultant. That was sometime after noon on March 1. The final terms of that contract are set forth in the written agreement signed March 15.

However, the fact there was a contract and benefits were received under that contract doesn't satisfy the requirements of 16-901(8). That is because the statute requires, in addition to there being a contract, promise or agreement that agreement had to "result in the extension of credit." If the additional requirement for the contract to "result in the extension of credit" didn't mean anything, it wouldn't be in the statute.

I am aware of no cases or other authority in the commercial world finding that where a contract for services exists, that contract creates "an extension of credit" from the point in time when the recipient of the services receives the benefit of the services. For instance, contracts for employment services and other personal services contracts aren't

extensions of credit until they are past due. My law firm provides legal services but there is no "extension of credit" for those services until the bill is past due.[1]

As I said in our formal written response, the CCEC itself recognizes this when it recognizes that contracts for regularly recurring services including employment services aren't an extension of credit until they are past due. Put in technical accounting jargon, the CCEC uses cash accounting for when to recognize regularly recurring expenses. Here, the contract for Internet Consulting and Related services which we provided for the consulting fee to be paid monthly beginning on March 21.

We've provided the consultant's contract. It is typical and well within the range of normal compensation and structure for compensation. The only thing different than say a press secretary or director of GOTV or general campaign consultant is that part of what the internet consultant does is visible - website and email. However, there is no basis in statute or rule for treating that contract differently than for other consultants.

If the legislature when it enacted 16-901 or the People when they passed Clean Elections wanted to provide that an expenditure occurred on the date a service was provided or when a contract was entered into, it would have been simple enough to do so. The fact that the statute wasn't amended is significant. In all due respect, the CCEC cannot interject a term into the statute that simply doesn't exist.

It has also been suggested that prior to March 15 this wasn't a recurring expense because the contract was not yet in writing and it was only once the written contract was entered into on March 15, that the contract became a recurring expense. However, as a matter of contract law matter, there is no basis for distinguishing between written service contract and oral service contracts. There is certainly nothing in the statute or the rules that distinguishes between them. The statute just looks to ordinary commercial law. Indeed, a large number of employment service contracts are simply oral - you'll get paid this much for the campaign which works out to this amount monthly.

If the CCEC wants to distinguish between oral and written service contracts, in all fairness to the candidates, it should do so by rule so there's a chance for input and vetting and so we avoid this type of problem.

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[1] It seems apparent that the legislature meant to utilize normal commercial understanding of extension of credit when it wrote this statute. See for instance for 16-901(5)(b)(xii) which states:
"An extension of credit for goods and services made in the ordinary course of the creditor's business if the terms are substantially similar to extensions of credit to nonpolitical debtors that are of similar risk and size of obligation and if the creditor makes a commercially reasonable attempt to collect the debt, except that any extension of credit under this item made for the purpose of influencing an election which remains unsatisfied by the candidate after six months, notwithstanding good faith collection efforts by the creditor, shall be deemed receipt of a contribution by the candidate but not a contribution by the creditor."

2.<u>There is No Prohibition on Entering into Contracts Prior to Filing or Raising Money.</u>

On some level it appears that the complaint really is that the contract with the vendor was really entered into prior to the filing and that is either illegal or unfair. For all the reasons explained above, there was no enforceable contract before March 1. However, even if there was, it did not violate the Clean Elections Act. Even if there was an enforceable contract before March 1, it is a service contract for periodic payment, and therefore not an expenditure under the statute or rules until that payment is past due. We could have entered into a written contract on Feb. 15 which called for payment on March 2 and not have had a reportable expenditure until March 2 (assuming it is a real commercially reasonable contract.)

ARS 16-901(8) doesn't make the time of entering into a contract the date of expenditure nor does it make the date or receiving services the date of an expenditure unless that contract results in the extension of credit. To read the statute differently simply ignores the language regarding the extension of credit. In fact, the CCEC has already recognized what is well recognized in the commercial world, a services contract with periodic payments isn't an extension of credit until its past due.

Some have raised concerns that this interpretation of the statutes will undermine the scheme for matching funds under Clean Elections. They posit the following hypothetical. An IE enters into a regularly recurring expense form of consulting services contract and that contract includes a website and emails that goes up right before election day but isn't payable until after election day. The concern is that under the existing law and rules a clean candidate wouldn't get matching funds. That is correct.

However, I don't believe this is really a major concern in the real world, and, if it is, it needs to be addressed by changing the statute or rule. Because of the speed and minimal cost of responding to email attacks, it is relatively easy to respond to this type of last minute attack. That is different than attacks by "snail mail" or TV where printing and postage which have to be ordered or airtime purchased. That has already been addressed by the CCEC which has already determined that those expenditures, which are not regularly occurring services, occur on the date of order. That distinction makes some sense because the post office, printers and TV and radio stations who "sell the medium" aren't consultants on a services contract.

If the CCEC believes that is a significant concern, it could consider suggest amending A.R.S. §16-901(8) or by creating a rule that provides that that regularly recurring expense contract entered into within thirty days prior to an election need to be recognized on an accrual basis rather than the current cash basis recognition.

However, it is unfair to the Napolitano campaign that relied on the existing statutes, rules and guidelines to plan its campaign to impose such a rule for the first time in an enforcement proceeding.

Supplemental Respondent Response
Received from Andrew Gordon on 05-22-06

3. **The Campaign had donations on hand at the time the website went up exceeding the value of the website.**

Even if the internet consulting contract did not become a regularly recurring expense until the contract was put into writing; there is still no violation over which the CCEC has jurisdiction. That is because the campaign had funds sufficient to cover the expenditure when it occurred. Prior to when the website went up on March 1, the Napolitano campaign had collected and deposited $3320, of which $1160 was from the candidate and the remainder was $120 early money contributions.

The website that went up on March 1 after was a very minimal "micro site." It included minimum information about the candidate; it had no video; it had no links to press releases, no bio, no calendar or the like. It had maybe 4 or 5 pages for links basically to collect $5 contributions and early money. That is to be contrasted with our current web page (which has totally replaced the early web site) which contains over a thousand pages, is highly interactive, and has streaming video. The original website could have been purchased for approximately $1,000 and, according to our consultant, took 6 to 8 hours or less of programming time to prepare.

Therefore, even if extension of credit means nothing, when the campaign utilized the internet consultants services and "formed the contract," the campaign already had more than enough money to pay for the site if the site had been purchased on a stand alone basis. Thus there isn't a basis for claiming a violation of R2-20-104(D)(6).